



**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS**

Draft

Date Amended:	05/02/07	Bill No:	AB 882
Tax:	Sales and Use	Author:	Hernandez
Related Bills:			

BILL SUMMARY

This bill would provide a sales and use tax exemption for energy efficient products, as defined, on April 22 (Earth Day) of each year beginning in 2008.

Summary of Amendments

The introduced version of this bill proposed a one week exemption period during the first week of October.

ANALYSIS

CURRENT LAW

Under existing law, the sales or use tax applies to the sale or use of tangible personal property in this state, unless otherwise exempted or excluded by statute. Under current law, the sales and use tax applies to sales and purchases of appliances to the same extent as it applies to any other sale of tangible personal property that is not otherwise exempted or excluded from tax by statute.

PROPOSED LAW

This bill would add Section 6398 to the Sales and Use Tax Law to provide a sales and use tax exemption for sales and purchases of “energy efficient products,” on each April 22 Earth Day, beginning in 2008. The bill would define “energy efficient products” to mean a product that meets or exceeds the applicable ENERGY STAR efficiency requirements developed by the United States Environmental Protection Agency and the United States Department of Energy.

As a tax levy, the bill would become effective immediately upon enactment, but operative on April 22, 2008.

IN GENERAL

ENERGY STAR is a joint program of the U.S. Environmental Protection Agency (EPA) and the U.S. Department of Energy for the purposes of conserving energy and protecting the environment through energy efficient products and practices.

In 1992 the EPA introduced ENERGY STAR as a voluntary labeling program designed to identify and promote energy-efficient products to reduce greenhouse gas emissions. Computers and monitors were the first labeled products. Through 1995, EPA expanded the label to additional office equipment products and residential heating and cooling equipment. In 1996, EPA partnered with the U.S. Department of Energy for particular product categories. The ENERGY STAR label is now on major appliances, office equipment, lighting, and home electronics. The EPA has also extended the label to cover new homes and commercial and industrial buildings.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board’s formal position.

The EPA's ENERGY STAR website (<http://www.energystar.gov>) provides a listing of qualified ENERGY STAR products in various product categories:

- Appliances include battery chargers, clothes washers, dehumidifiers, dishwashers, refrigerators and freezers, room air conditioners, room air cleaners, and water coolers.
- Heating and cooling equipment includes air-source pumps, boilers, central air conditioning, ceiling fans, dehumidifiers, furnaces, geothermal heat pumps, home sealing (insulation), light commercial (heating and cooling equipment used in commercial buildings) programmable thermostats, and ventilating fans.
- Home electronics include battery charging systems, cordless phones, digital-to-analog converter boxes, DVD products, external power adapters, home audio, podcasts, televisions (TV), TV/VCR and TV/DVD combination units, and VCRs.
- Home envelope include doors, home sealing (adding insulation and sealing air leaks to stop drafts) roof products, skylights, and windows.
- Office equipment includes computers, copiers, external power adapters, fax machines, laptops, mailing machines, monitors, multifunction devices (combines printing, scanning, and faxing all into one unit) printers, and scanners.
- Lighting includes compact fluorescent light bulbs, residential light fixtures, ceiling fans, traffic signals, and exit signs.
- Commercial food service includes commercial fryers, commercial hot food holding cabinets, commercial solid door refrigerators and freezers, and commercial steam cookers.
- Other commercial products include battery charging systems, exit signs, external power adapters, roof products, traffic signals, transformers, vending machines, and water coolers.

To encourage individuals to buy energy efficient products, ENERGY STAR partners (manufacturers, utilities, and state agencies) offer rebates on qualified ENERGY STAR products. In addition, certain ENERGY STAR products may be eligible for federal income tax credits.

In 2001, legislation was passed in response to reducing peak electricity consumption which was straining the adequacy and reliability of California's electricity system. The legislation provided funding to the California Energy Commission and other state agencies for grants and rebates to reduce electricity peak load demand. The legislation also directed the California Energy Commission to update the standards of energy efficient appliances.

Initiated in 2001, Flex Your Power is California's statewide energy efficiency marketing and outreach program (<http://www.fypower.org>). Flex Your Power is a partnership of California's utilities, residents, businesses, institutions, government agencies and nonprofit organizations working to save energy. The program's primary funding is from the Public Goods Charge as approved by the California Public Utilities Commission. The Flex Your Power website provides information regarding qualified ENERGY STAR products. The website also provides information on rebates and incentives for buying ENERGY STAR products. Currently, rebates for ENERGY STAR clothes washers

range from \$35 to \$150 per unit. There are also rebates, ranging from \$30 to \$175, for ENERGY STAR air conditioners, dishwashers, and refrigerators.

BACKGROUND

Several bills were introduced during the 2001- 2002 Legislative Session in response to California's energy crisis, but failed to pass. These bills included the following:

AB 695 (Pescetti) – would have added a sales and use tax exemption for sales and purchases of energy efficient residential and commercial refrigerators, room air-conditioners, clothes washers, and dishwashers. This bill failed to pass through the Assembly Appropriations Committee.

AB 124X (Pescetti) – was similar to AB 695 and would have added a sales and use tax exemption for sales and purchases of residential and commercial appliances that are energy efficient. This bill was never heard in a committee.

AB 52XX (Reyes) – was similar to AB 695 and would have added a sales and use tax exemption for sales and purchases of energy efficient appliances and florescent lightbulbs. This bill failed to pass the Assembly Appropriations Committee.

AB 27X (Koretz) and SB 71X (Perata) - would have, among other things, provided a sales and use tax exemption for purchases of power generating equipment, and, as an alternative, provide an income tax credit for costs incurred for the purchase and installation of a power generation system. These bills were held in the Assembly Appropriations Committee.

AB 51X (Daucher) - would have added an exemption for generators installed under a qualified interruptible service contract of 3 years or more in duration. This bill was never heard in a committee.

AB 58X (Cox) and AB 1319 (Cox) - both would have provided a state tax exemption for any solar energy system designed to provide thermal energy for the purpose of heating water or providing electrical power, as specified. AB 58X was held in the Energy Costs and Availability Committee. AB 1319 died in the Assembly Revenue and Taxation Committee.

AB 3052 (Pescetti) – would have exempted from sales and use tax sales and purchases of energy efficient residential and commercial refrigerators and clothes washers, as specified. This bill was never heard in a committee.

SB 1074 (Soto) - would have, until January 1, 2003, exempted from sales and use tax sales and purchases of microturbines, fuel cells, photovoltaic cells, solar thermal water heating systems, wind energy equipment, and electrical generators operating on renewable biomass fuel. This bill died in Senate Revenue and Taxation Committee.

SB 877 (Poochigian) - would have exempted purchases of qualified cogeneration equipment, as defined, for use on dairy farms, and would also have authorized an income tax credit for an amount equal to the portion of property taxes attributable to those fixtures and improvements to a dairy farm utilized in the cogeneration or transformation of dairy industry by-products into fuel sources used for the operation of that dairy farm. This bill died in the Senate Revenue and Taxation Committee.

COMMENTS

- 1. Sponsor and purpose.** This bill is sponsored by the California Retailer's Association and is intended to promote the purchase of energy efficient products.

2. **The May 2, 2007 amendments:** 1) limit the exemption period to one day a year, on each April 22 Earth Day, rather than the first week in October, beginning in 2008; and 2) provide provisions related to layaway sales and other orders placed during the exemption period.
3. **Exemption would apply to purchases of any product that carries the ENERGY STAR label.** Under the United States Environmental Protection Agency's (EPA) Energy Star website (<http://www.energystar.gov>), there are a variety of ENERGY STAR products. ENERGY STAR products include dishwashers, clothes washers, refrigerators, furnaces, programmable thermostats, computers, scanners, fax machines, DVD players, doors, windows, fluorescent light bulbs, vending machines, commercial fryers, commercial hot food holding cabinets, and more. ENERGY STAR products are purchased for home or personal use and purchased for business use.

Is it the author's intent that the exemption apply to purchases of all products carrying the ENERGY STAR label? Is it the author's intent for the exemption to apply for an individual's home or personal use and to apply for trade or business use? Also, is it the author's intent that the exemption apply to sales of used items? For example, a used appliance dealer sells a used late model refrigerator where the ENERGY STAR label is still attached to the product. Would the sale of the used refrigerator be exempt from tax? Clarification of these issues will assist Board staff in administering the exemption.

4. **Exemption applies to layaway sales and other orders placed during the exemption period.** Because the exemption only applies for each April 22nd, the bill contains language to address certain transactions that may overlap exempt and taxable periods. The bill provides that layaway agreements entered into on each April 22nd, for which the purchaser has made a deposit of at least 10 percent of the sale price, would qualify for the exemption. The bill also provides that orders placed during the one-day exemption period and paid for in full, but delivered subsequent to the exemption period, would also qualify for the tax exemption.
5. **Exemption may not apply to some merchandise exchanges and rain checks.** Under current law, when merchandise is returned for other merchandise, the law considers the transaction as two separate transactions: a rescission of the original sale and a separate sale of the replacement merchandise. For example, if a customer purchases a deluxe refrigerator and exchanges the refrigerator for a smaller model, the transaction is regarded under the law as a separate sale of the smaller model refrigerator and a rescission of the original sale of the deluxe model refrigerator. The retailer is allowed to deduct from his or her taxable sales amount for purposes of reporting the correct amount of sales tax to the Board, the sales price of the deluxe model refrigerator, and is also required to include in his or her taxable sales amount, the sales price of the smaller model refrigerator. Using this example under the proposed exemption period, if the deluxe model refrigerator is purchased during the exemption period, and is exchanged for the smaller model refrigerator *after* the exemption period, the proposed exemption would not apply to the exchange of the smaller model refrigerator since that transaction is recognized under the law as having occurred after the exempt period. This may result in reporting errors by retailers and added confusion and inquiries by customers.

Another source of confusion could result from the use of rain checks. Current law also provides that a rain check issued by a retailer does not constitute a sale of tangible personal property. Therefore, if a retailer is out of stock of a particular item and issues a rain check to the customer during the exemption period, and the customer subsequently uses the rain check to purchase the out of stock item after the proposed exemption period, the exemption would not apply.

6. **Impact on retailers.** Creating an exemption that only lasts one day would place an additional burden on retailers to have their cash registers programmed to tax sales on that one day and not tax sales on other dates. This may require retailers to incur costly reprogramming of their registers to accommodate the change. Retailers would presumably be compensated for this by increased sales activity during the one-day period.

Based on information in a 1990 report that the Board prepared to determine the impact on retailer's costs with respect to implementing a tax increase in 1989, on average, retailers with quarterly prepay accounts spent \$94.35 to reprogram their cash registers and computers. Retailers with monthly and quarterly accounts paid \$19.47. Adjusting these figures for an increase in the California Consumer Price Index and the increase in the number of accounts since the 1990 study, it is estimated that retailers incur approximately \$9.3 million in comparable reprogramming costs to implement a rate change.

7. **Other States.** The following states provide a sales tax holiday for energy-efficient products:

- Connecticut enacted a sales tax holiday period on residential weatherization products for the period of November 25, 2005, through April 1, 2006, then reinstated the holiday period for the period June 1, 2006, through June 30, 2007. Residential weatherization products include: programmable thermostats, window film, caulking of a type marketed for preventing drafts (caulking of windows and doors), window and door weather strips, insulation (attic and wall insulation, spray foam insulation, water pipe insulation, heating duct insulation, and switch and outlet insulators), water heater blankets, water heaters, and ENERGY STAR boilers, natural gas and propane furnaces, windows, and doors.
- Florida enacted a one-week sales tax holiday for new energy-efficient products in October of 2005 and 2006. Energy-efficient products include any dishwasher, clothes washer, air conditioner, ceiling fan, incandescent or fluorescent light bulb, dehumidifier, programmable thermostat, and refrigerator that have been designated as meeting or exceeding the federal ENERGY STAR efficiency requirements and has the ENERGY STAR label affixed to the product or product packaging. The sales tax exemption applies only to products having a sales price of \$1,500 or less per product, and must be purchased for noncommercial home or personal use.
- Georgia enacted a four-day sales tax holiday for energy-efficient products in August of 2005 and 2006. Energy-efficient products include any dishwasher, clothes washer, air conditioner, ceiling fan, fluorescent light bulb, dehumidifier, programmable thermostat, refrigerator, door, and window that have been designated as meeting or exceeding the federal ENERGY STAR requirements and have a sales price of \$1,500 or less per product. The exemption applies to products purchased for home or personal use.

8. **Construction contractors.** The one-day exemption would apply to construction materials and products such as doors, windows, ceiling fans, programmable thermostats, and more. The exemption would also apply whether the purchaser is a property owner, tenant, or construction contractor, and whether the products are to be used in existing real property or new construction. There is no limit on the number of products a person can buy during the exemption period. Contractors could purchase large quantities of construction materials or products without tax, even though they may not enter into a contract to furnish and install the windows until after the exemption period.
9. **The exemption applies to use tax transactions.** California consumers ordering these products from out-of-state, Internet and mail order retailers would be entitled to the exemption during the same period.

COST ESTIMATE

Administrative costs would be incurred in preparing and mailing a special notice to affected retailers, creating and distributing new sales tax charts to affected retailers, and answering potentially numerous inquiries. A detailed cost estimate is pending.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

This bill would provide a sales and use tax exemption for energy efficient products, as defined, for each April 22nd Earth Day, beginning in 2008. The bill would define “energy efficient products” to mean a product that meets or exceeds the applicable ENERGY STAR efficiency requirements developed by the United States Environmental Protection Agency (EPA) and the United States Department of Energy.

The EPA provided Board staff with a list of Energy Star products, as well as the number of units of each product sold in the United States. The table below lists each product, the US shipment unit, the estimated number sold in California, the estimated average price of each product, and the estimated sales.

Energy Star Products	Number Sold in U.S.	Estimated Number sold in California	Estimated Average Price	Total California Energy Star Sales (million of dollars)
Office Equipment				
-Office Copiers	83,333	10,000	\$ 3,000	30
-Office Facsimile	338,700	40,644	\$ 825	34
-Office Printers	16,740,207	2,008,825	\$ 3,800	7,634
-Office Scanners	2,215,927	265,911	\$ 1,028	273
-Office Multi-function				
Devices	2,921,970	350,636	\$ 2,125	745
-Office CRTs	3,450,295	414,035	\$ 149	62
-Office LCDs	11,429,619	1,371,554	\$ 295	405
-Office PCs	36,673,969	4,400,876	\$ 760	3,345
Home Office Equipment				
-Residential Copiers	0	0	N/A	
-Residential Facsimile	984,418	118,130	\$ 200	24
-Residential Printers	21,219,832	2,546,380	\$ 150	382
-Residential Scanners	5,043,349	605,202	\$ 200	121
-Residential M-F				
Devices	210,091	25,211	\$ 200	5
-Residential CRTs	2,204,705	264,565	\$ 150	40
-Residential LCDs	7,303,414	876,410	\$ 295	259
-Residential PCs	23,307,133	2,796,856	\$ 535	1,496
Home Electronics				
-TVs	10,245,164	1,229,420	\$ 7,700	9,467
-VCRs	3,077,109	369,253	\$ 501	18
-TV-VCRs	3,700,609	444,073	\$ 150	67
-DVD Players	3,776,414	453,170	\$ 70	32
-Mini-Systems	1,302,425	156,291	\$ 180	28
-Home Theater	827,798	99,336	\$ 260	26
-Audio Separates	436,300	52,356	\$ 75	4
-CD Players	0	0	N/A	
-Answering Machines	0	0	N/A	
-Cordless Phones	1,714,976	205,797	\$ 80	16
-DSS Cordless Phones	4,411,160	529,339	\$ 115	61
-Combo Phones	2,050,332	246,040	\$ 130	32
-DSS Combo Phones	6,488,116	778,574	\$ 85	66
-Additional Handsets	2,265,486	271,858	\$ 30	8
-Satellite Receivers	0	0	N/A	
-Analog Cable Boxes	0	0	N/A	
-Digital Cable Boxes	0	0	N/A	
-Digital Converter	2,977	0	N/A	
-Videophone	0	0	N/A	
-PVR	0	0	N/A	
-Video Game	0	0	N/A	
-Internet Appliance	0	0	N/A	
-Multifunction Set-Top				
Box	0	0	N/A	
Subtotal Set-top Box	2,977	0	N/A	
-External Power	16,210,999	1,945,320	\$ 195	379

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

Supplies				
-Battery Charging				
Systems	0	0	N/A	
Residential Appliances				
-Clothes Washers	3,362,513	403,502	\$ 250	101
-Dishwashers	5,980,078	717,609	\$ 465	334
-Refrigerators	3,666,426	439,971	\$ 1,025	451
-RACs	4,186,278	502,353	\$ 280	141
-Dehumidifiers	1,800,489	216,059	\$ 230	50
-Air Cleaners	208,583	25,030	\$ 450	11
-Exhaust Fans	828,991	99,479	\$ 155	15
-Ceiling Fans Only	3,022,565	362,708	\$ 65	24
-Ceiling Fan with Light				
Kit	368,355	44,203	\$ 250	11
-Light Kit for Ceiling				
Fan	130,276	15,633	\$ 60	1
Commercial Appliances				
-Vending Machines	68,591	8,231	\$ 3,400	28
-Hot Food Holding				
Cabinet	10,625	1,275	\$ 3,000	4
-Steamers	4,404	528	\$ 8,300	4
-Fryers	5,771	693	\$ 1,600	1
-Commercial				
Refrigeration	104,170	12,500	\$ 3,500	44
-Water Coolers	726,361	87,163	\$ 425	37
HVAC				
-Air Source Heat Pump	58,986	70,078	\$ 4,000	280
-Geothermal Heat				
Pump	32,517	3,902	\$ 20,000	78
-Central Air Conditioner	1,245,729	149,487	\$ 3,500	523
-Gas Furnace	1,312,302	157,476	\$ 1,200	189
-Oil Furnace	7,603	912	\$ 2,130	2
-Gas Boiler	55,091	6,611	\$ 4,000	26
-Oil Boiler	83,434	10,012	\$ 4,000	40
-Unitary HVAC	196,289	23,555	\$ 4,500	106
-Thermostats	2,207,844	264,941	\$ 95	25
Lighting				
-Indoor Fixtures	7,466,180	895,942	\$ 150	134
-Outdoor Fixtures	3,057,502	366,900	\$ 340	125
-Exit Signs	1,954,725	234,567	\$ 165	39
-CFLs	80,456,805	9,654,817	\$ 10	97
-Traffic Signals	654,074	78,489	\$ 300	24
Other				
-Utility Transformers	0	0	N/A	
-C&I Transformers	6,686	7,762	\$ 10,000	78
-Residential Roofing	0	0	N/A	
-Commercial Roofing	3,000	0	N/A	
Total				\$28,082

Total California sales are estimated to be \$28.1 billion. Board staff anticipates sales of these products to be higher than average for the period when these sales would be exempt from the sales tax. The state of Texas found that during a one-week sales tax

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

holiday period of clothing and footwear, sales were double that of a regular weekly period. Based on this information, Board staff assumes that the one-day period represents 2/365 of a year's worth of sales. Thus, using the information above, Board staff estimates sales to be \$154 million.

REVENUE SUMMARY

The revenue impact from exempting \$154 million in purchases of the energy efficient products from the sales and use tax for a period each year would be as follows:

	Revenue Loss
State loss (5.25%)	\$ 8.1 million
Local loss (2.00%)	3.1 million
Special district loss (0.69%)	<u>1.1 million</u>
Total	\$12.3 million

Analysis prepared by:	Debra A. Waltz	324-1890	05/04/07
Revenue estimate by:	Dave Hayes	445-0840	
Contact:	Margaret S. Shedd	322-2376	

0882-2dw.doc